

Moscow Financial Weekly

For the week ending September 26, 2003
Treasury Attache's office, U.S. Embassy Moscow

Highlights

- Mortgage-Backed Securities bill discussed, may be approved soon
- CBR aims to increase reserves above \$65 million by year end

Key Economic Indicators

Indicators	Level	% chg 1 week	% chg since Jan. 1
Ruble/\$ (MICEX) UTS	R30.5700	-0.20	-3.82
Monetary Base*	R1200.1 bln	0.12	27.63**
CPI	NA		8.3
International Reserves*	\$62.1 bln	0.00	30.19
RTS Index (end of week)	554.32	1.36	54.38
Refinancing rate	16	0	-23.8

*For week prior

** % chg from the abnormally high seasonal level at the end of the year.

Economic Developments

According to Goskomstat information, **capital investments** increased by 12.2% y-o-y in August while during the first eight months of the year, capital investments grew at 12% y-o-y. The impressive growth can be explained by higher world prices for natural resources: the investments have been made primarily in the fuel and metallurgy sectors.

In addition, **domestic consumption** continues to strengthen. Based on the data released by Goskomstat, real income increased by 9.8% y-o-y in August and by 13.4% y-o-y during the period of January-August 2003. At the same time, retail turnover weakened slightly in August -- increasing by 6.1% y-o-y -- but it may bounce back later this fall with minimum wages increases beginning October 1. However, retail trade for the year is still strong, increasing by 8.4% in the first eight months of the year

According to the Ministry of Economic Development and Trade (MEDT), **GDP** will increase by 5.2% in the second half of 2003, while during the first half it was up by 7%. The Ministry's annual forecast stands at 5.9%. The projected growth in the second half of 2003, as with the private forecasts above, is due to higher oil prices caused by lower production in OPEC countries. However private analysts are expecting even higher

For the week ending September 26, 2003

growth, with some estimates up to 8%, perhaps betting on a repeat of the performance in the second half of 2002, when GDP growth increased sharply.

Banking sector

Oleg Vyugin, CBR First Deputy Chairman, said that the CBR will **increase foreign currency reserves** by the end of the year to at least \$65 billion, despite the recent decline in their levels. While reserves now stand at \$62.75 billion, they reached an all-time record of \$64.9 billion on June 20 and July 4, 2003.

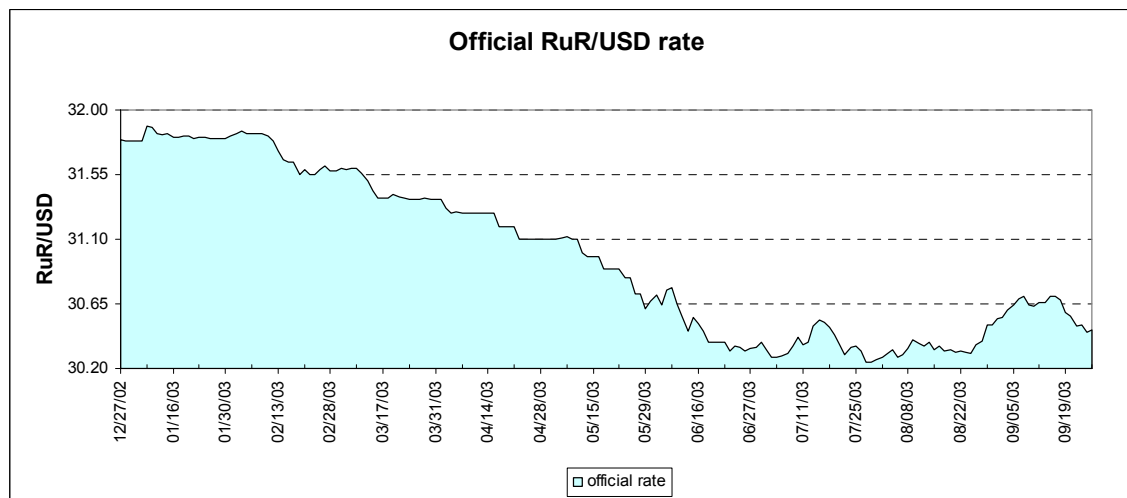
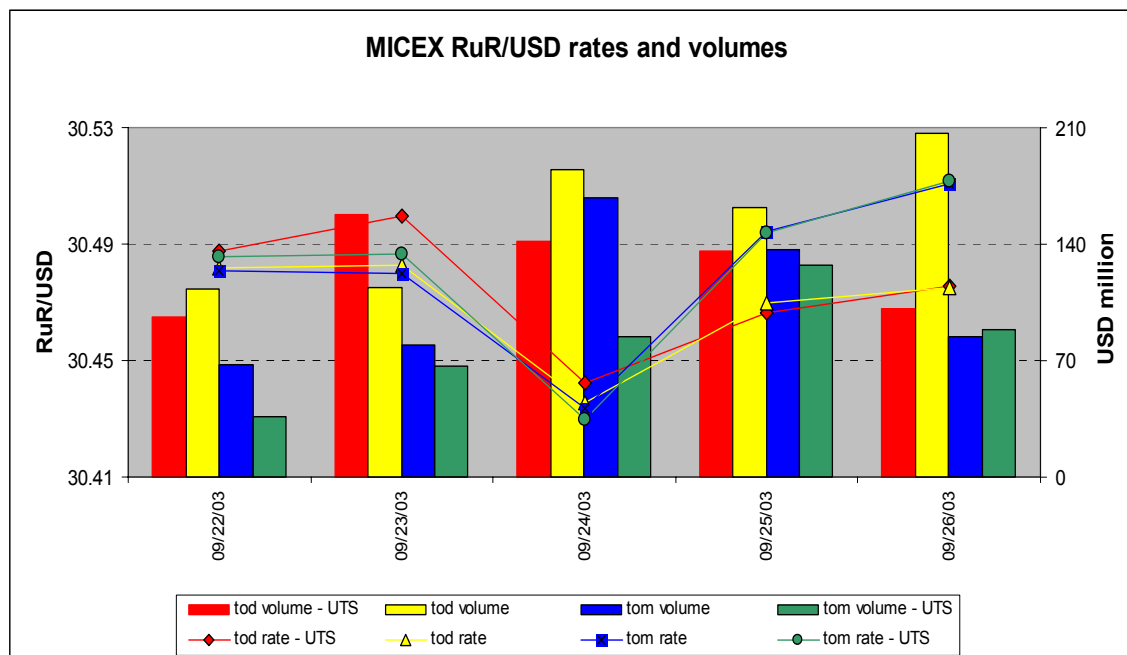
Irina Sedova, Deputy Director of the CBR Department of Bank Regulation and Supervision, said at a meeting of the Committee on Mortgage Lending of the Association of Russian Banks (ARB) that the CBR proposes two versions of the bill on **mortgage-backed securities**. According to the first, only specialized credit organizations will be allowed to issue such securities. Such institutions will not be allowed to attract deposits. This will minimize risks, but the number of such specialized institutions will be limited, Sedova said. According to the second version of the bill, universal banks may issue mortgage-backed securities, but in this case the CBR will apply stringent regulatory demands to the banks, similar to those that are to be applied to participants in the deposit insurance system. Sedova supported the ARB's proposal to adopt, simultaneously with the bill on mortgage-backed securities, an amendment to the law on bankruptcy. The idea of this amendment is to exclude mortgage collateral from the bankrupt bank's estate, which would significantly reduce risks for buyers of mortgage bonds. The ARB estimates the potential size of mortgage market in Russia at \$2-5 billion; today bank mortgage loans total about \$150 million. Duma Deputy Ivan Grachev assured the participants at the meeting that the bill on mortgage-backed securities will be passed in all three readings in this Duma session, adding that the GOR had not changed its position: only specialized institutions should be allowed to issue such securities.

Financial markets

Forex Market

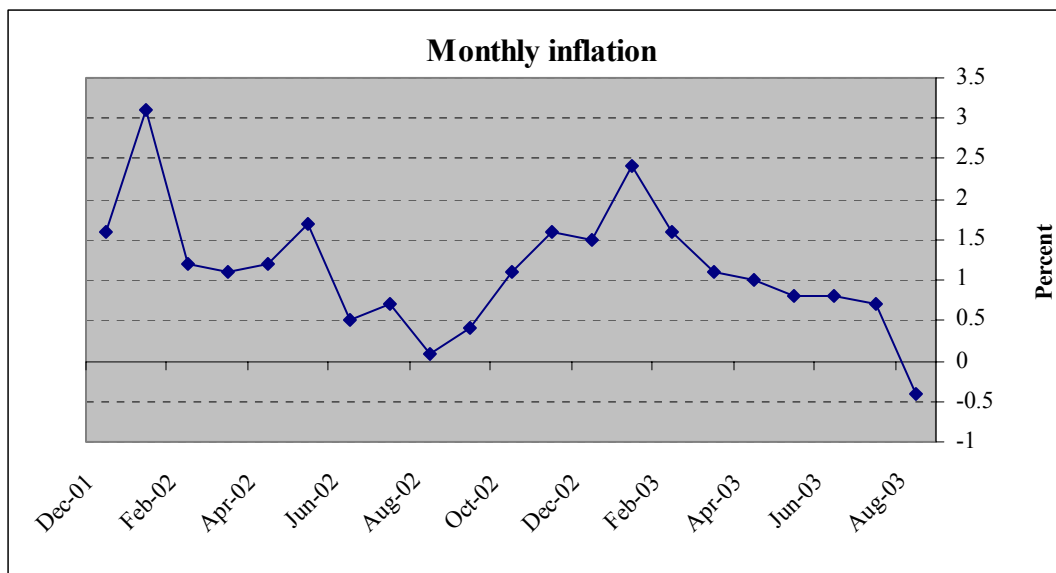
Last week, the demand for dollars remained remarkably high given the continuing ruble strain, the main cause of which is probably the increased demand for hard currency itself due to lower domestic interest rates. In the first half of the week the dollar slid against the ruble, but once banks completed their excise tax payments, the dollar strengthened again.

For the week the ruble firmed against the dollar 0.31%, closing in the UTS on Friday at R30.4754/\$. MICEX weekly trade volumes were \$633.50 million and \$403.14 million, \$779.98 million and \$535.06 million for the UTS "tod" and "tom" sessions, and SELT "tod" and "tom" sessions, respectively.



Prices

MEDT Minister German Gref believes that inflation in September will amount to no more than 0.5%. Traditionally, inflation is low during the months of July-September due to the seasonal decrease in the prices of fruits and vegetables. Inflation typically starts to increase again in last quarter of the year.



Eurobonds

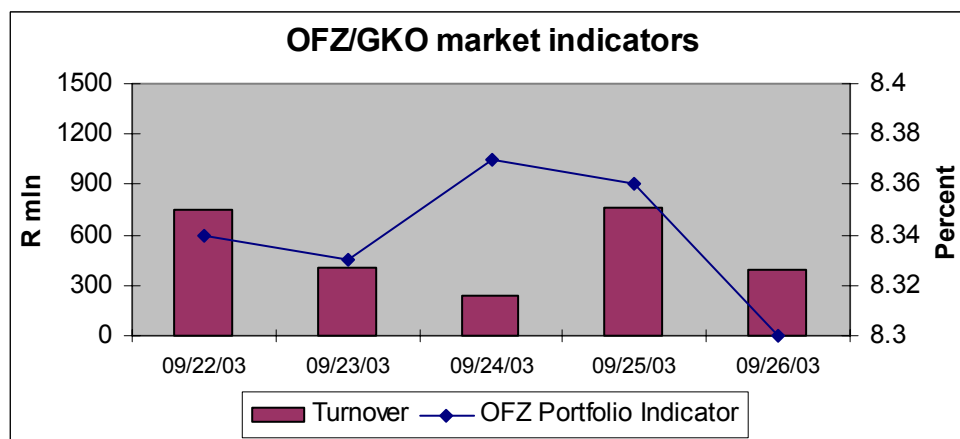
The Russian Eurobonds sector experienced a downward price correction last week, on increased volatility of U.S. Treasuries, but ended the week marginally stronger, in line with U.S. Treasuries. The negative news from Argentina added to the selling pressure on the whole emerging market sector, including Russian paper. Russian Eurobond prices continue to be affected by mostly external factors.

Interest/Bond Market

Bonds/Bills

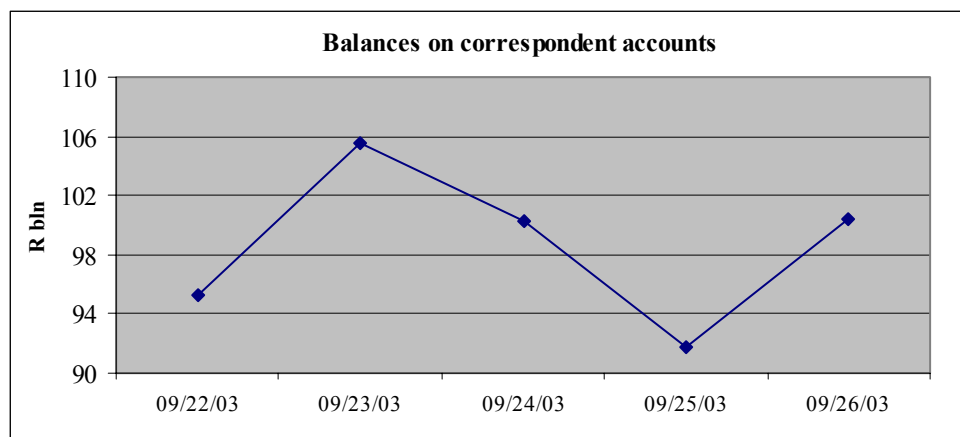
The relatively severe shortage of rubles on the market, accompanied by high overnight ruble loan rates of over 10% slowed the activity on the secondary OFZ/GKO market. Yields were moving in a very thin range, ending the week slightly down on lower-than-average trade volumes.

The Finance Ministry plans to make a total of R18 billion in OFZ/GKO placements in October. The first auction of R14 billion will be held on October 8. On that day, OFZ coupon payments will be made. Given the increased ruble liquidity that typically occurs at the beginning of each month, the Ministry will likely be able to place these issues with no premium. The next R4 billion auction is expected to be held on October 22.

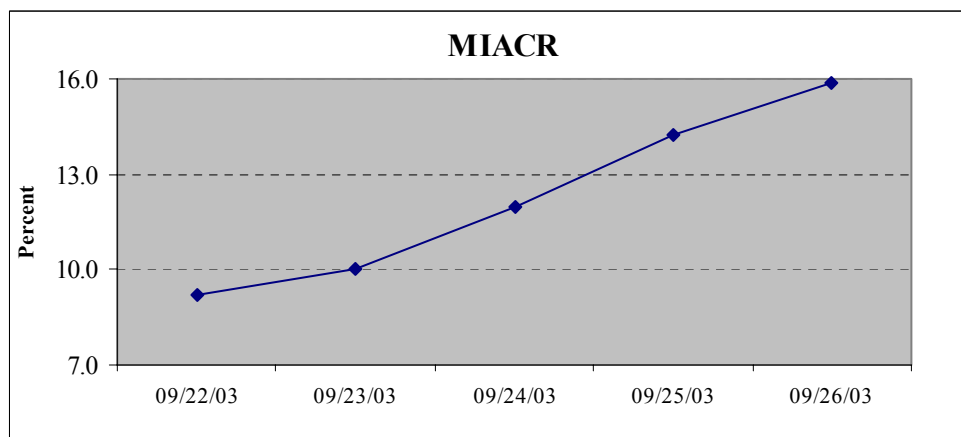


Overnight rates

Banks experienced another week of ruble liquidity tension, with average daily balances on banks' correspondent accounts at the CBR totaling R98.7 billion. The shortages are explained by both end-of-month and end-of-quarter factors, the latter due to mandatory tax payments by banks for their clients. In addition, at the end of the week the mineral extraction tax had to be paid, which caused overnight ruble loan rates to jump up to 22% p.a. on Thursday and then further up to 25-30% p.a. the next day. Banks have also experienced severe liquidity shortages over the past month due to rising domestic credit in August, which caused an appreciation of the ruble. Bank clients, expecting a depreciation of the ruble vis a vis the dollar, started buying dollars which aggravated the ruble shortage and forced overnight rates higher.

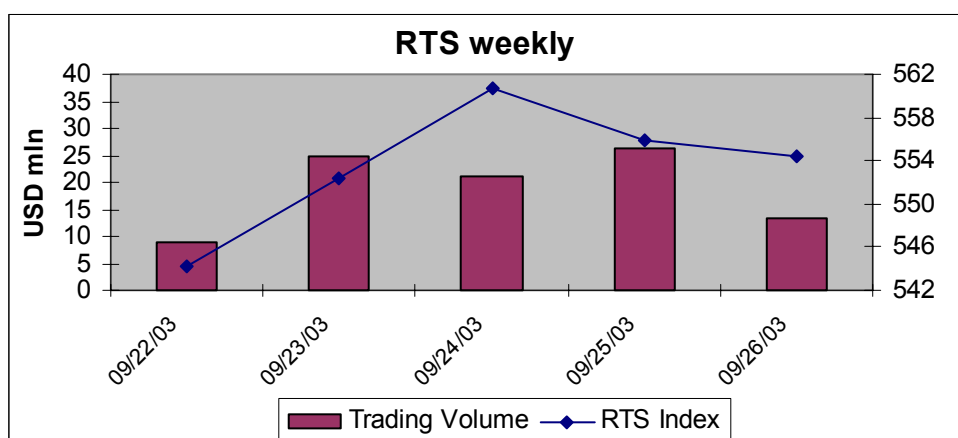


For the week ending September 26, 2003

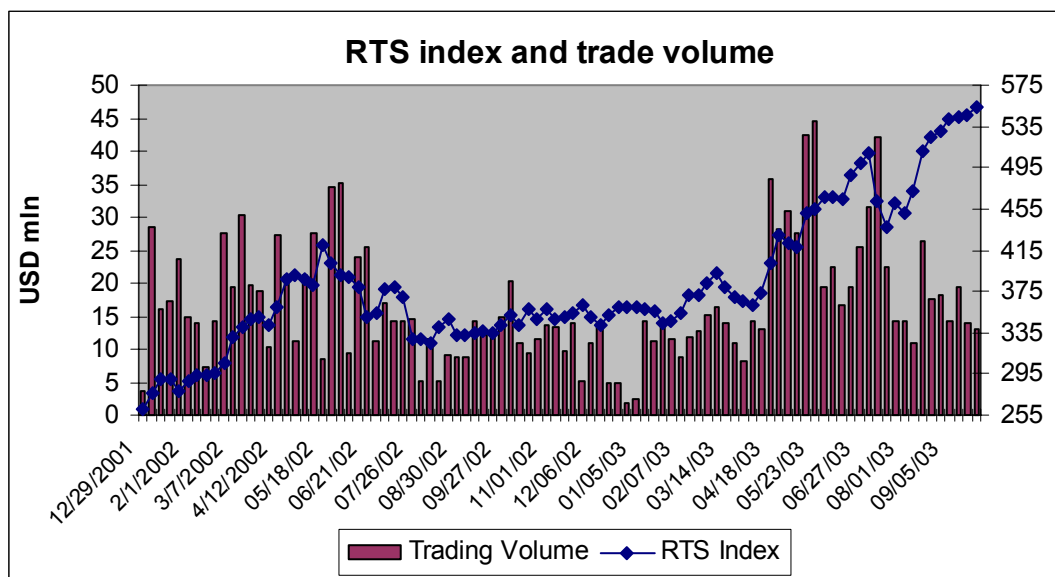
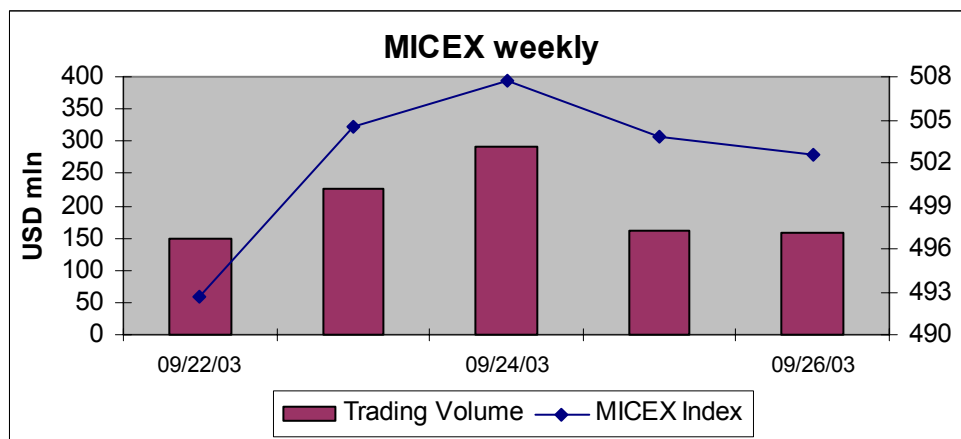


Stock Market

Last week the Russian stock market was in a period of consolidation, based in part on the continuing ruble deficit in the market. Oil prices spiked up in the middle of the week, which supported the stock market through an increase in the prices of oil-company shares. In addition, last week saw higher demand for regional energy shares. Selling by foreigners was offset by the bullish attitude of Russian investors. By Wednesday, the RTS index had reached another 6-year high. A downward price correction took place during the following two sessions and the RTS index finished the week up by 1.36% in dollar terms. Trade volumes were at moderate levels throughout the week.



For the week ending September 26, 2003

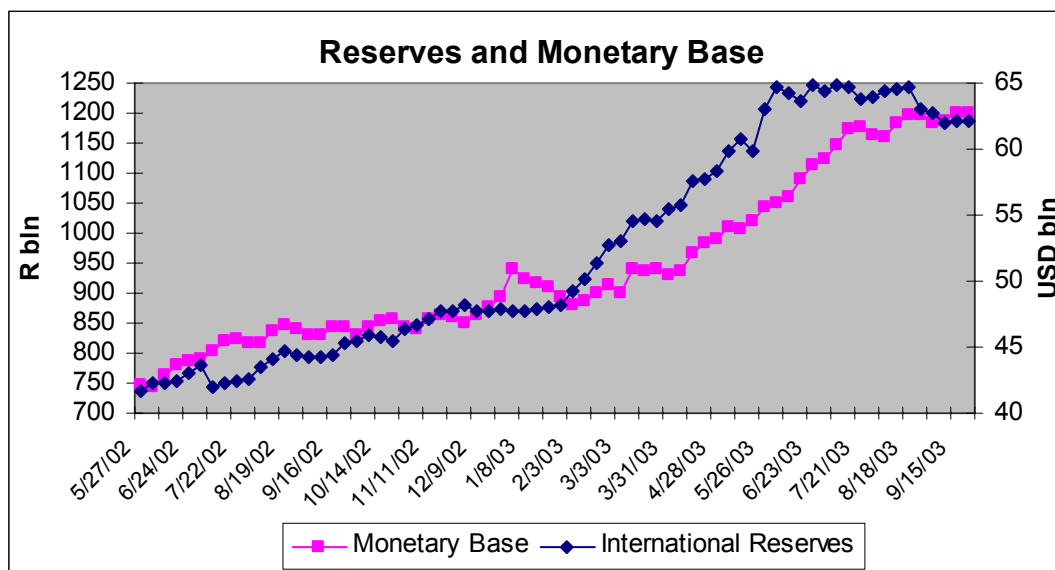


International Reserves and Monetary Base

The international reserves of the CBR as of September 18 remained at the same level as the previous week, totaling 62.1 billion. This is still an increase of 30.19% from the beginning of the year.

The monetary base grew modestly last week, piercing through the 1200 level and stopping slightly above it at R1,220.1 billion, 0.12% (R1.4 billion) higher than the previous week.

For the week ending September 26, 2003



EXPLANATORY NOTES

1. EXCHANGE RATES: SELT - "System of Electronic Lot (currency) trading" -- a computer based OTC-style trading system organized by the Moscow Interbank Currency Exchange (MICEX). MICEX Unified Trading Session (UTS) is the one in which exporters have to sell 50% of the repatriated currency. UTS "tom" weighted average as of 11:30 becomes the "official" exchange rate for the next day. "\$-tod" price is the price of the dollar with same day delivery. "\$-tom" is the price of the dollar with delivery on the next day. Minimum lot size for each of the dollar instruments is \$100,000. Average price is quoted as the weighted average of all actual deals entered into the system by various banks.

2. INTEREST RATES: Moscow InterBank Actual Credit Rate is calculated as the average-weighted rate on the volume of actual transactions in interbank loans by commercial banks.

3. STOCK INDICES: The RTS index is the only official indicator of the Russian Trading System. It is calculated every 30 minutes of the RTS trade session, starting at 12:00. It comprises 60 shares of 35 leading companies. These shares are included in so-called Category "A" listings. The index indicates over-the-counter stock prices. The index represents the ratio of the total market capitalization of the shares of the companies selected for the index to the total market capitalization of the same shares as of the initial

date multiplied by the index value as of the initial date (31 December 1997) using a base of 100 beginning September 1, 1995. The ruble-adjusted index is a derivative of the main dollar index, using the same base. The MICEX index is calculated by the stock section of the Moscow Interbank Currency Exchange and is based on the price fluctuations of 17 shares of the MICEX's first and second listings.

4. INTERNATIONAL RESERVES OF THE RUSSIAN FEDERATION represent the amount of reserve assets of the Bank of Russia and Finance Ministry. Those reserve assets are comprised of monetary gold, special drawing rights, the reserve position in the IMF and other liquid foreign assets. The latter include short-term deposits in non-resident and resident banks, balances in current accounts, foreign government securities, repo agreements with these securities made with non-residents, and other liquid assets (accrued interest on these assets is not included). Monetary gold is evaluated at a floating rate, revised periodically, but not always reported immediately. Foreign currency assets are converted into U.S. dollars on the basis of the cross rates of foreign currencies to the dollar, calculated using the official rates of the ruble to these foreign currencies, as set by the CBR.

5. MONETARY BASE (M1) is comprised of cash and reserves of commercial banks on deposit in the CBR. It is the basic part of the money supply (M2).

6. LOMBARD CREDITS, distributed through auctions, are aimed to provide liquidity to the banking sector. These credits are extended to banks on the basis of collateral.